

Internal Revenue Service
Appeals Office
3310 El Camino Avenue Suite 170
Sacramento CA 95821-6318

Department of the Treasury

Taxpayer Identification Number:

Person to Contact:

Name Daniel Frisch

Tel:

Fax:

Release Number: **201323035**

Release Date: 6/72013

Date: March 15, 2013

Tax Period(s) Ended:

Certified Mail

UIL: 501.32-00
501.33-00

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective September 19, 2007.

Our adverse determination was made for the following reason(s):

A substantial amount of your organization's assets inured to the private benefit of your founder. Because a substantial amount of your charitable assets were used for private purposes, the organization is not operated exclusively for exempt purposes described in section 501(c)(3) of the Code.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Forms [1120 or 1041] for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have

to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

A handwritten signature in black ink, appearing to read "Hugh D. Whittedge", with a stylized flourish at the end.

Hugh D. Whittedge
ACTING Appeals Team Manager

Enclosure: Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: October 19, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B – name
C – name
D – name
E – name
F – name
G – credit card
H – credit card
J – credit card
K – credit card
M – trust
N – state
P – date
Q – country
R – country
S – city
T – year
U – year
V – year
X – vehicle
Y – clothing line
Z – retail store

UIL:

501.32-00
501.33-00

Dear,

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issues

1. Do you pass the operational test required of 501(c)(3) organizations? No, for the reasons described below.
2. Do the personal expenses of B and E result in prohibited inurement as described in section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations? Yes, for the reasons described below.
3. Do you maintain adequate records showing sufficient control and discretion to ensure that your distributions are used exclusively for charitable, educational, and religious purposes as described in section 501(c)(3) of the Code? No, for the reasons described below.

Facts

You were formed as a nonprofit corporation in the state of N on P. Your Articles of Incorporation list your purposes as follows:

- To provide referral services and information to families and children concerning medial, psychiatric, mental health, substance abuse treatment and employment matters;
- To provide job placement services for unemployed and/or underemployed individuals;
- To provide information and assistance to families coping with domestic violence, and to refer the family to the appropriate profession, social worker, or state agency;
- To operate a telephone hotline to provide free referrals to medical, mental health, substance abuse, or other professionals;
- To provide children and teenagers with mentors/role models to encourage development of productive habits and to discourage drug/alcohol use and other self-destructive behavior;
- To sponsor safe and responsible social and recreational activities for children and teenagers, including dance, theater, arts/crafts, and sporting events;
- To provide limited financial assistance to underprivileged families or children to help ensure that they have access to appropriate medical, mental health, drug treatment and other professional services;
- To sponsor classes and/or seminars for children and families concerning substance abuse prevention, substance abuse treatment, domestic violence, education, employment and other social issues.

Your Articles of Incorporation also limit your purposes as being exclusively for

charitable, educational, scientific or religious purposes within the meaning of section 501(c)(3) of the Code.

The above purposes reflect the activities listed in your 1023 application. You anticipate that the majority of individuals using your services will be working poor or lower middle class. You further clarify that you give lectures and pass out religious based literature, such as prayer books, brochures, and audio recordings of lectures. Your events take place in the local community, as well as in Q and R. You maintain a website that provides free audio and video classes to visitors and includes listings of your events schedule. You spend % of your time on weekly mentoring programs for teenagers and young adults, % on organizing and hosting formal events and lectures, % on medical referrals, % on fundraising, and % on administrative functions. B travels domestically and internationally on your behalf to work with similar organizations throughout the world.

Your budgeted expenses include compensation (approximately % of total expenses), events and meetings (approximately % of total expenses), supplies (approximately 15% of total expenses), travel expenses and air fare (approximately % of total expenses), and other administrative expenses. You indicate travel expenses include gas, tolls, flights, and vehicle lease. You also pay meals and travel expenses for volunteers, including providing food at lectures and events.

The General ledgers you provided show the following expenses (in approximated numbers):

- Year T
 - Facilities and equipment (including vehicle) - \$
 - Office Expense - \$
 - Operations - \$
 - Program Expenses - \$
 - Travel - \$
- Year U
 - Facilities and equipment (including vehicle) - \$
 - Office Expense - \$
 - Operations - \$
 - Program Expenses - \$
 - Travel - \$
- Year V (first quarter only)
 - Facilities and equipment (including vehicle) - \$
 - Office Expense - \$
 - Operations - \$
 - Program Expenses - \$
 - Travel - \$

A further breakdown of your program expenses includes holiday distributions, library,

outside services, lectures, shabbatons, clothing, medical, events, programs, and other.

Your board of directors consists of B, C, and D. B, who is also known as F, organizes weekly events for the community, determines the content of lectures and of literature, hires speakers, supervises volunteers, and fundraises. B is the only compensated board member, earning around \$_____ per month. You later stated that B's compensation is around \$' _____ a month, working approximately 25 hours a week.

E is B's spouse. E serves as a volunteer, working with youth and distributing goods to needy individuals. E was an initial board member, but was removed when you decided to appoint a board that did not consist of family members.

B is responsible for the day to day control of your financial transactions including ensuring revenues are deposited and expenses are properly paid. All donations are deposited in your bank accounts by B, or by a volunteer under the direction of B. All expenses and contracts must be approved by B or the accountant, who reports all transactions to B. B is the sole signatory on your bank accounts. You determined there is no need to have more than one individual with check signing authority. Because B is most familiar with your activities, he was given this authority. This decision was made to simplify record keeping. The board of directors reviews financial statements every six to eight weeks.

You reimburse expenses of volunteers and board members. In the past, you have not required volunteers to submit documentation of reasonable expenses because B is familiar with your activities and B approves all expense reimbursements. You state you were deficient in maintaining expense substantiation and reimbursement records due to the rapid growth and nature of your activities. Currently, you require an expense report and/or receipts for all expenses. Invoices and receipts are furnished to your accountant for recordkeeping, but not for payment or approval. The majority of reimbursement requests are submitted by B.

You explain that volunteers are permitted to make cash withdrawals at ATMs to assist with pressing needs. Volunteers are limited to minimal cash withdrawals and all your funds are subject to review by B and accountants who report to the board. Examples of these withdrawals include cash withdrawals at various casinos in S. You indicated you send volunteers to help troubled youth who gamble there. Your volunteers withdraw funds there, which are used to assist youth pay gambling debt and provide transportation. The amount ranges up to around \$_____ at a time. No reports were provided to substantiate how withdrawn funds were used.

You indicate you have had irregular cash flow from donations. This has forced you to rely on loans and credit cards to pay expenses. You state donations eventually allow you to cover your expenditures. You used borrowed funds rather than decreasing spending because of your irregular cash flow and because many of your activities are not planned since you do not turn away those who are in need.

You sometimes borrow money from donors, other organizations, or persons sympathetic to your goals to pay monthly bills. You indicate you usually repay such loans within a 60 day period. You do not formally document loans and have never borrowed money from a bank or financial institution. You indicated the loans are repaid by check wire transfer.

You indicate B and E have used too much of their own funds and credit to finance your irregular cash flow needs. Unsigned board meeting minutes were provided for T and U. In T, the minutes state B offered to lend you up to \$ interest free which will be paid back with the proceeds of fundraising. The loan shall have payment priority to the broadest legal and possible extent. In addition, B proposed at this meeting to use B's personal credit cards for your expenses. It was determined you would use B's credit cards for seven months and then re-evaluate the agreement. In U, you met and determined your current system of loans and repayments was the most effective.

B has loaned funds to sustain operations since your formation. When needs arise, B advances funds to ensure continued operations by allowing you to use B and E's personal credit cards. B approves the loan in conjunction with consultation among board members. There is no interest charged by the officer other than interest charged by the credit card companies. B is reimbursed to the extent that normal operations can be funded with remaining funds.

You rely on seven credit cards: three issued to you, three issued to E, and one issued to an inactive company of B. You rely on the credit cards issued to B and E because of your limited credit availability. All credit cards were issued to B or E or personally guaranteed by B or E.

Your General Ledger balance sheet lists 4 credit cards, G, H, J, and K, though the actual ledger lists up to seven additional credit cards, which appear to be paid off each year. In T, your credit card liabilities totaled around \$ and in U, around \$. In the first quarter of V, your credit card balance was around \$. You also reported loans payable in the Current Liabilities section of your balance sheet. Your loans payable amounts total approximately \$ and \$ in T, U, and the first quarter of V, respectively.

The loans payable is broken into three sections: CC Payments, Unknown, and M, who is unrelated to you. The CC Payments section of your General Ledger is primarily increased by credits which appear to be payments to the credit card companies. The Unknown and M section are increased by loaned funds deposited in your bank account. The CC Payments account is decreased by debits to a subaccount entitled Salary - F. The debits are primarily for credit card purchases made at several high-end clothing stores, such as Z. This account has also been decreased for checks written to B. The Unknown account and M account are decreased by checks written from your bank account, which appear to be loan repayments. You also make payments from your bank

account to the G, H, J and K accounts.

Account statements from the credit cards you use were provided. The statements show multiple purchases of floral arrangements, jewelry, salon services, lawn service, and clothing from high-end stores, such as Y and Z. You indicated floral arrangements were purchased for events, for your facility, and as gifts of congratulations. You indicate jewelry and clothing from high-end stores are made to reward volunteers for exceptional efforts. The recipients are normally recommended by B or other board members. You state that if items are provided to B, they are treated as compensation.

The lawn service expenses were categorized on the ledger as both Maintenance and Office Expenses in U. They were later included in schedule itemizing items paid by you for B's benefit (see schedule information below). Some clothing purchases were treated as reductions to a loans payable account on the general ledger, discussed above. However, some clothing purchases were categorized as Clothing expenses on the general ledger. You first indicated that you purchased clothing for those in need as part of your charitable programs. You later stated clothing purchases at high end stores are treated as gifts or compensation.

You prepared a schedule entitled 'Loan Due to Officer.' It itemizes amounts paid on your behalf by B on B and E's credit cards. Essentially, it increases for credit card payments B makes to cover your expenses. You state this account is reduced by payments made by you against the balance. You also provided another schedule, entitled 'Transaction Detail,' which details all items paid by you that were for B's benefit or were unclear and charged to his account. You indicate in T, the amount due to B was almost \$ _____. Per your records, the amount of personal items you paid for B's benefit was nearly \$ _____. In U, the amount you owed to B was around \$ _____. The amount of personal expenses you paid for B's benefit was around \$ _____.

Personal expenses identified as line items on credit card bills are reviewed by outside accountants who report any irregularities to the board. Your accountant erred on the side of being conservative by treating any expenditure that was unclear as personal to B and E. If it was not clear that if an expense pertained to you, it was treated as a personal expense of B and E and charged to B's compensation/loan account.

You provided B and E's Form 1040s for T and U. These list their adjusted gross income as approximately \$ _____ a year.

E has a lease for a vehicle which is used almost exclusively by B and paid for by you. The lease shows the vehicle is a new X. The agreed upon value of the car upon signing the lease in U was almost \$ _____. The lease payment was approximately \$ _____ a month. You explain E leased the vehicle because you did not have sufficient credit history to lease the vehicle directly. B uses the car to get to and from work and go to meetings and appointments. You state B may use the vehicle for incidental personal errands at the end of a work day, but the family has a separate vehicle for travel

unrelated to your operations. You pay for the gas, maintenance, and other vehicular expenses for this car. No written documentation between you and E was provided showing your agreement to pay E's lease.

Law

Section 501(c)(3) of the Code provides, in relevant part, exemption from federal income tax for corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Regulations explains that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of Regulations explains the prohibition against private inurement as follows: Distribution of earnings. An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Rev. Rul. 56-304, 1956-2 C.B. 306 states that an organization which otherwise meets the requirements for exemption from federal income tax are not precluded from making distributions of their funds to individuals, provided such distributions are made on a true charitable basis in furtherance of the purposes for which they are organized. However, organizations of this character which make such distributions should maintain adequate records and case histories to show the name and address of each recipient of aid; the amount distributed to each; the purpose for which the aid was given; the manner in which the recipient was selected and the relationship, if any, between the recipient and (1) members, officers, or trustees of the organization, (2) a grantor or substantial contributor to the organization or a member of the family of either, and (3) a corporation controlled by a grantor or substantial contributor, in order that any or all distributions made to individuals can be substantiated upon request by the Internal Revenue Service.

Rev. Rul. 68-489, 1968-2 C.B. 210 describes an organization exempt from federal income tax under section 501(c)(3) of the Code that distributes part of its funds to organizations not themselves exempt under that provision. The exempt organization ensured use of the funds for section 501(c)(3) purposes by limiting distributions to specific projects that are in furtherance of its own exempt purposes. It retains control and discretion as to the use of the funds and maintains records establishing that the

funds were used for section 501(c)(3) purposes. Held, the distributions did not jeopardize the organization's exemption under section 501(c)(3) of the Code.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 325 U.S. 844 the Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purpose.

In Church in Boston v. Commissioner, 71 T.C. 102 (1978), the court found that the organization's officers received amounts of money in the form of "grants." These grants carried with them no legal obligation to repay any interest or principal. Petitioner contended, as it had during the administrative proceeding before the Service, that the grants were made in furtherance of a charitable purpose: to assist the poor who were in need of food, clothing, shelter, and medical attention. However, petitioner was unable to furnish any documented criteria which would demonstrate the selection process of a deserving recipient, the reason for specific amounts given, or the purpose of the grant. The only documentation contained in the administrative record was a list of grants made during one of the three years in question which included the name of the recipient, the amount of the grant, and the "reason" for the grant which was specified as either unemployment, moving expenses, school scholarship, or medical expense. This information was insufficient in determining whether the grants were made in an objective and nondiscriminatory manner and whether the distribution of such grants was made in furtherance of an exempt purpose. The failure to develop criteria for "grant" disbursements or to keep adequate records of each recipient can result in abuse. Accordingly it was found that the organization failed to establish that their disbursements constituted an activity in furtherance of an exempt purpose under section 501(c)(3) of the Code.

In Western Catholic Church, Petitioner v. Commissioner of Internal Revenue, 73 T.C. 196; (1980), the petitioner's only activities were some individual counseling and distribution of a few grants to needy individuals, while its primary activity was investment of funds. The directors borrowed money in its name, but used some of it for automobiles and to pay off personal loans. The petitioner's failure to keep adequate records and its manner of operation made it impossible to trace the money completely, but the court found it clear that money passed back and forth between petitioner and its director and his for-profit businesses. The Court held that petitioner had not shown it was operated exclusively for exempt purposes or that no part of its earnings inured to the benefit of its officer.

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the organization's founder and his wife executed vows of poverty and transferred all their possessions and income to the organization on the condition that it qualified under IRC 501(c)(3). The founder controlled all financial decisions of the organization. The court found that a substantial purpose of the organization was to serve the private interests of the founder and his

wife. Accordingly, the court held that the organization did not qualify under IRC 501(c)(3).

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), an organization operated bingo at a bar (a for-profit enterprise) for purposes of raising money for scholarships. The board of directors included the bar's owners and accountant, and two other persons. The court reasoned that, because the bar owners controlled the organization and appointed its directors, the organization's fundraising activities could be used to the advantage of the bar owners, and thus, provide them with a maximum private benefit. The organization claimed that it was independent because there was a separate accounting and that no payments were going to the bar. The court maintained that the organization's and the bar's activities were so interrelated as to be "functionally inseparable." A separate accounting did not change that fact. Thus, the organization did not operate exclusively for exempt purposes, but rather benefited private interests – the bar owners. Exemption was properly denied.

In Rameses School of San Antonio, Texas v. Commissioner of Internal Revenue, T.C. Memo. 2007-85, 2007 WL 1061871 (US Tax Ct. 2007) the court held that the IRS properly revoked the exempt status of a school on the grounds that its earnings inured to the benefit of its founder, who also served as its executive director, president, and CEO. The record showed that the founder issued numerous organization checks to herself and withdrew cash from organization accounts for which the record showed no documented business purposes. The record also contained thousands of dollars of expenditures directed to retail stores, credit card companies, financial institutions and other businesses for which there was no evidence of a business purpose or board authorization. Records did not show there was any documented system for loans to/repayments by the founder or for loans by the founder and reimbursements from the school. The school failed to establish it was operated exclusively for an exempt purpose, in that it was operated for the benefit of private interests and net earnings inured to the benefit of its founder. The facts showed factors indicative of a prohibitive relationship including control by the founder of the entity's funds, assets, and disbursements; use of entity moneys for personal expenses; payment of salary or rent to the founder without any accompanying evidence or analysis of the reasonableness of the amounts; and the purported loans to the founder showing a ready private source of credit. The organization had provided no credible information to support an exempt purpose for the expenditures.

Application of Law

Failure to Establish Operations Are Exclusively for Exempt Purposes

Based on our analysis you do not satisfy the operational requirements of the Code and Regulations to be recognized as exempt under section 501(c)(3) of the Code. You have not shown you are organized and operated exclusively for exempt purposes and not for the private benefit of your creators, designated individuals or organizations controlled by

such private interests. Moreover, you have not shown that you are formed exclusively for an exempt purpose under section 501(c)(3) of the Code.

To be exempt under section 501(c)(3), an organization must be both organized and operated for one or more exempt purposes specified in the section. The presence of a single nonexempt purpose, if substantial, will preclude exemption regardless of the number or importance of exempt purposes. See Better Business Bureau ruling. An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more purposes specified in section 501(c)(3). Similarly, you have the non-exempt purpose of operating for the private benefit of your board member B, and B's spouse, E. Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. By allowing B to control your financial decisions, including when to make loans, when and how to repay loans, what expenses to reimburse, and when to make cash withdrawals, an environment for allowing your funds to be used for private benefit is created. The method of repayment of funds through undocumented, unapproved payments of personal expenses demonstrates your existence privately benefits B and E. An organization is not operated exclusively for one or more exempt purposes if its net earnings inure to the benefit of private shareholders or individuals, or its activities further private rather than private interests.

Like the organization in Rameses, your operations show factors indicative of prohibited inurement and private benefit - control by your founder, B, over your funds, assets, and disbursements; payments of personal expenses to your founder without any evidence or analysis of reasonableness; and an ability of your director to make disbursements without apparent financial controls. This is evident in your methods for accounting for certain expenditures. You state your accountant erred on the side of being conservative by treating any expenditure that was unclear as personal to B and E. If it was not clear that if an expense pertained to you, it was treated as a personal expense of B and E and charged to B's compensation/loan account. In all, you have been using personal credit cards to make purchases for reimbursement through your accounts. Certain purchases have been made for insiders, others you have stated were for volunteers, but you have been unable to thoroughly substantiate a significant amount of transactions controlled through personal accounts attributed to your operations. You have essentially mixed yours with personal accounts. Your failure to thoroughly explain this pattern of fund management, including insufficient documentation for many transactions, does not establish you are operated exclusively in furtherance of section 501(c)(3) purposes.

The misappropriation and mismanagement of your funds flow through to your founder, B, and B's family. This conclusion is based upon representations and materials in the application file that show you, B, and E are related and interconnected and have commingled finances and operations. See P.L.L. Scholarship v. Commissioner, supra, where the court found that activities of a taxpayer and lounge were so interrelated as to be functionally inseparable. Similarly, you, B, and E have financial transactions so

interrelated, it is nearly impossible to separate. A review of your books and the explanation provided as to your accounting methods demonstrates this point. The lack of fund management is found to be substantial and is considered to be in furtherance of non-exempt purposes and therefore prevents you from qualifying for exemption under section 501(c)(3) of the Code. See section 1.501(c)(3)-1(c)(1) of the Regulations, which provides that if more than an insubstantial part of its activities is not in furtherance of an exempt purposes then the organization will not be regarded as "operated exclusively" for one or more exempt purposes. Since transactions resulted in substantial private benefit to B and E, you have a substantial nonexempt purpose and do not qualify for exemption under section 501(c)(3).

Impermissible Private Benefit and Earnings that Inure to Insiders

Per Section 1.501(c)(3)-1(c)(2) of the Regulations, an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private individuals. Where an activity provides a direct benefit to private insiders, it does not matter that the benefit may be quantitatively insubstantial. Even a small amount of inurement is fatal to exemption. Your records show B is using B and E's personal credit cards both for personal and organizational expenses. Paying for personal expenses of B, a board member, confers a personal benefit to an insider and constitutes prohibited inurement. You are responsible for paying the credit cards or reimbursing for payments made by B. Paying for these personal expenses (clothing, lawn service, salon services) results in private benefit to B and E. An organization that operates for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests, by definition does not operate exclusively for exempt purposes. Since your operations result in inurement you do not qualify for exemption under Section 501(c)(3).

B has near absolute control and discretion over your operations, is solely responsible for your checking accounts, and has control and authority over all your financial matters. B has used loans he made to you to pay for personal expenses, such as clothes, lawn service, and jewelry. B authorizes all reimbursements, while at the same time being the individual requesting the majority of the reimbursements. B is authorized to make withdrawals of cash, which you identify as petty cash, for which no reports are required to be made. As was discussed in Rameses, were the founder of the school enriched herself by issuing checks to herself as payee and making cash withdrawals this constituted inurement. In this case, there was no documentation for loans and the founder had unfettered discretion to direct and manage the operation of the school. Likewise, you have an individual, B, that has unfettered control and discretion of your finances, your loan transactions have no discernable system or documentation, and you operate with limited board interaction. In addition, your records show that B received benefits by paying for personal expenses with funds he loaned to you. The records you have provided do not show these personal expenses were for any exempt purposes. You indicate B has put in more funds (loans payable) than he has received back.

However, the records provided do not show any substantiation these purchases were reported anywhere as compensation, nor do they show they were part of any formal loan repayment program agreed upon by all board members. As found in the Rameses case, the personal expenses received by B are considered to be similar and constitute inurement. Therefore, you are similarly regarded as not operated exclusively for exempt purposes because you are operated for the private interests that constitute inurement.

Similar to the organization in Basic Bible Church v. Commissioner, your founder, B, controls all your financial decisions. You state that B and E have already ready spent too much funding sustaining your operations. However, they continued to allow you to use their credit cards without any documented limitations. Though your board minutes stated B would loan around \$ _____ the amount of the loan payable due to B has reached as high as \$ _____ at times. B is also the one making the majority of the purchases. You indicate you have not cut spending due to the emergency nature of many of your operations; however, a significant portion of your expenses relate to office expenses, facilities, vehicles, and travel, which are all generally planned expenses. One example is the leasing of the X. This lease was entered into by E with no written documentation from you that you agreed to take over the lease payments. This resulted in a monthly payment of more than \$ _____ in addition to insurance, maintenance, and other vehicle expenses. There was no documentation your board were participants in the selection of the type of vehicle that was appropriate for both your operational or budgetary needs. The economic substance of this transaction, combined with the nature of the personal purchases of clothing, salon services, and other items, and reimbursement policies allowing B to approve his own reimbursements, show that B and E are using you to pay for personal expenses. You serve the private interests of B and B's spouse, E, and therefore, do not qualify under section 501(c)(3).

Failure to Maintain Sufficient Records to Establish Control and Discretion

You are like the organization in Church in Boston v. Commissioner, which described an organization that made distributions and failed to maintain adequate records. The court held that the grants the organization made were not in furtherance of an exempt purpose because the organization was unable to furnish adequate documentation in support of the funds given. Similarly, you have not furnished adequate documentation or described adequate controls over finances which lead us to a determination that no funds will be used to further private interests. Without procedures to determine which expenses are for exempt purposes and which are for personal expenses, it is impossible to know which expenses B is paying for, and which expenses you are paying for. The control B maintains over your funds combined with your system of loans through credit card usage creates an environment for the private use of your funds. Therefore, we are unable to determine you are operating for exclusively 501(c)(3) purposes.

You do not maintain adequate records required for exemption as found in Rev. Rul. 56-304. This ruling provides records and case histories should be maintained to show the

name and address of each recipient of aid; the amount distributed to each; the purpose for which the aid was given; the manner in which the recipient was selected and the relationship, if any, between the recipient and organization insiders. Although Rev. Rul. 56-304 describes requirements for distributions of funds to individuals these requirements are nonetheless applicable to distributions made to organizations to show any distributions are made on a true charitable basis. Aside from bank statements and a general ledger, you have provided very little documentation supporting financial transactions, including loans, donations, reimbursements, or personal expenses. In fact, you regularly refer to B, your board member, as the one most involved in these financial transactions and thus, having the sole authority. The nature of B's control over financial transactions and B and E's financial intertwining with you make it impossible to separate (see P.L.L. Scholarship). Your financial controls and records show B and E stand to benefit from your existence through your commingled financial activities. This private benefit to insiders precludes exemption under section 501(c)(3).

Your application and financial information shows you lack adequate accounting, record keeping, and cash controls. As discussed in West Catholic Church v. Commissioner, the failure to keep adequate records, a lack of records that allow funds to be traced completely, and instances where funds pass back and forth between parties caused the organization to be nonexempt. The court held that the organization was not able to show that no part of its earning inured to the benefit of its officer. Similarly, the materials in your application show numerous payments of personal expenses of B. The accounting for these transactions does not distinguish personal expenses paid and expenses paid to conduct your operations. You have classified lawn service expenses as your maintenance expenses and your office expenses, and also as personal expenses of B. You have classified clothing and jewelry purchases as your holiday payments, your clothing expenses, and the personal expenses of B. B has complete control of all financial transactions, which are reported only to an outside accountant. There are no procedures on how credit card purchases are recorded and tracked, and no written documentation of loan agreements. Based on your records, lack of financial procedures and controls, and lack of written documentation supporting personal expenses, it cannot be determined which purchases were made to support your programs and which purchases were personal expenses.

You are unlike the organization described in Rev. Rul. 68-489. In this ruling, an exempt organization showed that it would "ensure" use of the funds it disbursed for permitted purposes by retaining control and discretion as to the use of the funds and maintaining records limiting distributions to specific projects that further its own purposes. You did not maintain adequate records for the distributions you made, and you did not have adequate control and discretion to ensure charitable and religious purposes, rather than private interests, were exclusively furthered. The records and financial materials you have provided show that you do not maintain sufficient records and controls to detail your activities and financial transactions and, therefore, are unable to show that you exclusively further 501(c)(3) exempt activities.

Applicant's Position

You maintain you are only responsible for paying those expenses incurred by B and E that relate to and are incurred for the purpose of your charitable activities. You indicate B's personal expenses paid for by you are reported to B as compensation. You also hold that B has given you more funds than B has received in the form of personal expenses. Therefore, no net compensation was paid to B for either of those years, and also results in no benefit to B.

Service Response to Applicant's Position

Even though you state you are only responsible for paying organizational expenses, the financial information you provide shows otherwise. You used B and E's credit cards to pay for your expenses in the form of a loan from B. B and E also used the cards to pay for personal expenses. You then make payments to the credit card companies. There are no real policies, controls, or procedures in place to ensure the funds you pay are only for your expenses. Also, B has complete control of your financial transactions, and is the only one responsible for authorizing increasing loan amounts and making expenditures. You have provided no documentation showing personal expenses paid by you to B and E were ever reported as compensation. In addition, your records contain no written documentation in regards to loans. Specifically, you have not shown your board agreed to repay loans through paying personal expenses or any authorization of loan repayments at all. Given B's authority over your financial transactions and the inseparable nature of the finances between you, B and E, individuals are benefitting personally from your operations and you are not operating for public over private purposes.

Conclusion

You are not operated exclusively for 501(c)(3) purposes because you provide a substantial private benefit to your director B, and B's wife, E. The intermingling of personal with organization funding, combined with the payment of personal expenses of B and E, result inurement. Lastly, you do not maintain adequate records showing sufficient control and discretion to ensure that your distributions are used exclusively for charitable, educational, and religious purposes, rather than for the private interests of your insiders. Therefore, we conclude that you do not qualify for exemption under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more

information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

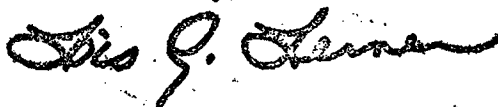
Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

A handwritten signature in dark ink, appearing to read "Lois G. Lerner". The signature is fluid and cursive, with the first name "Lois" being more prominent.

Lois G. Lerner
Director, Exempt Organizations

Enclosure, Publication 892